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“Government Accounting 101: Budgets, Deficits, and Debt”

<u>Introduction</u>

Much of the hoopla in the nation’s capital since Inauguration Day has involved money: The ubiquitous answer to all questions. Unequivocally, the new Administration has voiced a strong interest in budget, deficit, and debt (BDD) concerns. There are several fields of academic study that offer an opportunity to gain command of this topic, and there are many voter-taxpayer-citizens who have a reasonable command or grasp of some of BDD topics. But full comprehension of the BDD topic in all its gory detail is only enjoyed by a select few.

Recently, we were requested to provide a statistical note that presents a high-level explanation of BDD terms along with a parsimonious numerical analysis to ensure clarity. In our aim to fulfill this request, we recognized that the “high-level” analysis portion of the request veils a multitude of details. Silence on certain details may mean a reduction in analytical accuracy as a tradeoff for a reduction in the time and effort required to comprehend the BDD topic. A high-level grasp of the BDD topic is rewarding because it causes the uncertainty-based anxiety of “what is all of this about” to disappear. Below, we take BDD terms in sequence and then summarize and conclude. Our focus is the US Federal Government. Unless stated otherwise, our nomenclature includes colloquial terms for ease of understanding and may differ from accounting standards.

<u>Budgets</u>

It is nearly impossible to live in the US, be exposed to the media in its many forms, and not have some fundamental understanding of what a budget is by the end of secondary school. In fact, several states have adopted financial literacy programs intended to ensure this outcome. A solid and straightforward explanatory statement of a budget is: **A framework that accounts for the incomes, revenues, and receipts (hereafter, “receipts” to indicate sources of funds) that are expected to be available for spending during a period and the related expected expenditures [spending on operational goods (remuneration of employees, administrative expenses, materials and supplies, travel expenses, miscellaneous expenses, etc.) and services (consulting, printing, advertising, janitorial, utilities, waste management, etc.), plus spending on capital goods of the following varieties (completely new, major improvement to existing, alterations to existing, or major replacement of existing structures, equipment, inventories, or intellectual property)].**[i]

For many institutional units (households, nonprofit institutions, private corporate and noncorporate business, and even certain governments), a **balanced budget** is required or expected. However, given our coverage of the Federal Government, we emphasize that it does not confront a balanced budget requirement. By balanced budget is intended that the value of receipts is equal to or greater than the value of expenditures (operational and capital spending).

An important term floated in the just-given definition of a "budget" is "expected." At its core, a budget is a planning document. One plans a budget, but as the budget period unfolds, unexpected receipts and expenditures may occur. The unexpected budget-related occurrences are labeled "variations," which may be positive or negative. That is, during the budget period, values for various budget categories may be exceeded or there may be shortfalls relative to budgeted amounts. These variations do not alter budgets; but they are reflected in a final accounting for the period that represents actual receipts and expenditure outcomes. Column A of Table 1 presents a budget for a **hypothetical** Federal Government.

Table 1.—**Hypothetical** Budget, Accounting Outcomes, and Budget Variations

Line No.	Accounts	(A) **Hypothetical** Federal Government Budget ($ Trillions)	(B) **Hypothetical** Federal Government Accounting Outcomes ($ Trillions)	(C) **Hypothetical** Federal Government Budget Variations (C = B - A) ($ Trillions)
1	Total receipts	4.9	5.0	0.1
2	Total operational spending (Expense)	6.5	6.3	-0.2
3	Operating surplus (+)/**deficit (-)** aka Net saving (3 = 1-2)	-1.6	-1.3	0.3
4	Total capital spending	0.4	0.7	0.3
5	Total expenditure (5 = 2 + 4)	6.9	7.0	0.1
6	Overall surplus (+)/**deficit (-)** aka Net lending (+)/ **Net borrowing (-)** (6 = 1- (2 + 4); (6 = 1 - 5)	-2.0	-2.0	0.0

Source: BlackEconomics.org

<u>Surpluses/Deficits</u>

As already mentioned, because the Federal Government has no balanced budget requirement, its budget can reflect a **deficit** (for its operational and/or its capital budget components). In addition, institutional units, economic sectors, or their subsectors (the Federal Government is an economic subsector of the public sector) without a balanced budget requirement may reflect a surplus (operationally or overall). That is, after a budget period concludes and accounts are prepared, there will be a balance, surplus, or deficit outcome. Conceptually, surpluses indicate that actual receipts exceed spending (operational and/or capital). Deficits indicate the inverse outcome: Actual receipts are exceeded by spending (operational and/or capital).

A key point is that, while budgets and actual accounting outcomes are compared as part of a budget analysis effort, actual surpluses/deficits are just that; they are derived from actual outcomes, which forms a separate construct from the budget itself. Also, as outlined thus far, the inference is that surpluses/deficits represent overall accounting outcomes. However, current accounting conventions for governments use different nomenclatures for what might otherwise be referred to as operational and overall surpluses/deficits. Specifically, **operational surpluses/deficits** (the actual result of economic outcomes for the operational portion of a budget) are labeled **"net saving"** (this value represents a "surplus" or "saving" when positive and a "loss" when negative). O**verall surpluses/deficits** (the actual result of overall (combined operational and capital portions of a budget) economic activity for the period) are labeled **"net lending/net borrowing"** (when a positive value, it represents a "net lending" outcome because available funds can be extended as a loan; and when a negative value, it represents a "net borrowing" outcome because funds must be borrowed to cover the shortfall). Column B and lines 3 and 6 of Table 1 show net saving and net lending/net borrowing outcomes for a **hypothetical** Federal Government. Column C of Table 1 presents budget variations.

<u>Debt</u>

Imagine that a **hypothetical** new government is formed, a budget is prepared for it, and the first accounting period is completed, which results in a net borrowing outcome. In response, the new government must borrow to cover its shortfall. This borrowing is the government's first incurrence of debt. From that point forward, subsequent accounting periods may result in either balanced, net lending, or net borrowing outcomes. To the extent that net borrowing values exceed net lending values over time, then additional debt will be incurred. The intersection of Table 1's Column B and line 6 shows the net borrowing amount that must be covered by increasing the debt of the **hypothetical** Federal Government.

The just-described **hypothetical** scenario is applicable to the US Federal Government historical experience. The Federal Government's current debt level (over $36 trillion) reflects cumulative net borrowing and unpaid interest due on the debt over its nearly 250-year history. Admittedly, much of the current debt has accumulated over the past few decades.

<u>Summary/Conclusion</u>

This statistical explanatory note guides readers through an accounting labyrinth that begins with a planned budget and its two major components (receipts and expenditures (operational and capital)). It accounts for actual outcomes when governments attempt to implement their budgets ("surpluses/deficits" known by convention today as "net saving" or "net lending/net borrowing"); and it concludes by clarifying that "surpluses" or "deficits" create conditions for lending (surpluses) or borrowing (deficits). In the case of the US Federal Government, the cumulative historical outcome is a large volume of debt.

If "debt" is a considered unfavorable and problematic, then a relevant question is: How can it be avoided? The evidence is that many state and local governments operate under balanced budget requirements. Therefore, apart from borrowing for selected types of capital projects and unfunded liabilities (mainly employee post-retirement benefits) these governments have accumulated a limited amount of debt. Therefore, adoption of a balanced budget requirement is one approach to limit debt accumulation.

But debt is enabled by creditors who possess financial surpluses. If opportunities for lending to government decline, then the standard argument is that these financial surpluses will find their way to their best and highest ordered uses. The likely result is an increase in the production and consumption of consumer goods and services for domestic use or for export, and less production of government goods and services.

The just-given responses to the question concerning eliminating or limiting government debt are, admittedly, simplistic. In reality, the entire social system (especially political aspects) has evolved to facilitate—encourage even—government debt creation. Therefore, to eliminate or limit debt successfully, it may be necessary to transform the social system—political aspects of the social system at a minimum.[ii]

Your questions, comments, or concerns about this statistical explanatory note are welcomed at BlackEconomics.org.

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Endnotes

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[i] Expenditures of the operational type are expected to potentially be useful or consumed within one year; capital expenditures involve goods that are expected to remain functional/productive for more than one year.

[ii] A transformation of a political system that could be used to eliminate debt or to limit its creation, is explored in Brooks Robinson (2022), *A Purer Democracy under Cyber Governance: Future Implications for Black America's Political Economy*. BlackEconomics.org; https://www.blackeconomics.org/BEAP/apdbape.pdf (Ret. 030725).